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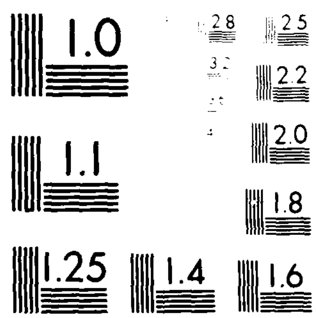

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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HUMAN RESOURCES DIVISION

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SEPTEMBER 23, 1981

The Honorable Verne Orr
The Secretary of the Air Force

Dear Mr. Secretary: (14) GAO/HRD-81-152

Attention: Assistant Auditor General

Subject: (6) Allocation of an Air Force Contractor's Pension Fund Assets May Be Inequitable (HRD-81-152)

During our review of contractors' compliance with cost accounting standards relating to pension costs, we found that the pension plan of Pan American World Airways, Inc. (Pan Am), had experienced significant actuarial gains from unanticipated job terminations of employees working on an Air Force contract.

At the time of our fieldwork in 1979, Pan Am had initiated actions to establish separate pension plans which would ensure that the Government received proper credit for these termination gains. However, as of July 1981, these actions had not been completed and it appears that the method proposed by Pan Am for allocating pension plan assets may not be equitable to the Government.

We believe that you should act to ensure that the pension plan established for employees working on Government projects receives an equitable share of assets.

BACKGROUND

The Air Force has contracted with Pan Am for services at its Eastern Test Range, Cape Canaveral, Florida, for over 25 years. The services are provided by Pan Am's Aerospace Services Division (ASD). Although the Division had a number of contracts, the contract for services at the Eastern Test Range was the largest.

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Pan Am provided pension benefits for its employees through its Cooperative Retirement Income Plan (CRIP). Pan Am is reimbursed by the Government for contributions to the plan for employees working on the Eastern Test Range contract. Pan Am's CRIP contributions relating to the Eastern Test Range contract were about $1.2 million, $1.5 million, and $1.8 million for 1975, 1976, and 1977, respectively.

We reviewed CRIP actuarial reports for 1973-77. While the 1973 and 1974 reports did not identify the actuarial assumptions that resulted in CRIP actuarial gains or losses, the actuarial reports for subsequent years provided these data. We also reviewed data, which Pan Am provided at our request, relating to employee terminations and employment history at the Eastern Test Range during 1975-77. Data for earlier years were not readily available. We did not verify the data Pan Am provided. In addition, we interviewed officials of the Air Force, Pan Am, and Pan Am's actuary.

GOVERNMENT DID NOT RECEIVE ADEQUATE CREDIT FOR TERMINATION GAINS

For 1975-77, the number of employees working on four projects in ASD 1/ who were expected to terminate was consistently underestimated.

The net termination gain of CRIP for 1975-77 was $5,310,499. Data provided by Pan Am showed that $1,346,936 or 25 percent of this gain resulted from ASD terminations on the four projects although less than 10 percent of the CRIP participants worked on these projects. However, actuarial gains and losses were assigned without regard to which groups of plan participants contributed to them.

On August 24, 1979, we briefed the Chief, Contract Management Division, Directorate of Contracting and Support, Detachment 1, Space and Missile Test Center, Patrick Air Force Base, and the contracting officer. We told them that, while we had not determined the amount, it appeared that substantial actuarial gains

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1/Pan Am provided data on four projects which are apparently Government contracts involving its ASD. Data relating to terminations and employment for the individual projects were not provided for 1975. Data for 1976 and 1977 showed that about 95 percent of the employees working on the four projects worked on the Eastern Test Range contract. Pension contributions relating to this contract were 94 percent or more of total contributions for the four projects for 1975, 1976, and 1977.

resulting from employee terminations had not been credited to the Government. We also advised them it appeared that Pan Am was not in compliance with Cost Accounting Standard 413 which provides that separate pension costs should be calculated for segments of an organization when certain conditions exist. One of these conditions is a material termination gain or loss attributable to the segment.

The Air Force officials said they would take action on the issues we raised, including determining the amount of overpayments, and would advise us of any actions taken or planned.

We also briefed Pan Am officials in August 1979. A Pan Am official agreed that Pan Am had been overpaid for pension costs by the Government. He said that Pan Am planned to account for pension costs by segment, i.e., for Government and for non-Government activities, in accordance with Cost Accounting Standard 413. He said this would eliminate the problems leading to the overpayments we found. He also said that Pan Am would calculate the distribution of pension plan assets both on the actuarial liability method and the net contribution method and an equitable allocation would be made to the Government.

The liability method allocates assets in proportion to the liability for pension plan benefits. The net contribution method allocates assets based on plan contributions, income, benefit costs, and expenses. Cost Accounting Standard 413 calls for use of the net contribution method when the data needed are readily determinable.

METHOD FOR ALLOCATING PENSION ASSETS APPEARS INAPPROPRIATE

As of May 1981, we had not been advised of any further actions. Therefore, we followed up to determine whether actions had been taken. We found that, although a proposal had been made in 1979 to allocate pension plan assets, the final allocations had not been made. Also, it appears to us that the method proposed may result in an inequitable distribution of assets.

On September 25, 1979, Pan Am advised the Air Force that it would allocate pension plan assets as follows.

1. Effective January 1, 1979, Government contract employees of ASD were transferred from CRIP to a new plan called ASD/CRIP which was established specifically for them. The insurance company handling the CRIP assets was to transfer assets from CRIP to ASD/CRIP based on actuarial liability.

2. When data became available, Pan Am's actuary would calculate the proper division of assets for CRIP and ASD/CRIP based on Internal Revenue Service regulations. The plans' assets would be adjusted based on this division.

3. The assets that should be available for each plan, and within ASD/CRIP for each project, would be determined on the basis of the net contribution method.

4. If the assets assigned to a project were less than what they should be, Pan Am would make contributions to ASD/CRIP for that project until the deficit is made up. If the assets assigned to a project were more than they should be, the project would make contributions to CRIP.

On July 7, 1981, Pan Am's actuary advised us that the amount of assets that should be assigned to the plans had not yet been determined. He said he needed additional data from Pan Am. He also said that 1969, when the plan was sufficiently funded, would be the starting point for determining what the plans' assets should be on the basis of contributions. Assets relating to years before 1969 would be distributed based on actuarial liability.

During our review we obtained data from Pan Am on personnel assigned to the Eastern Test Range contract. The data show that the number of U.S. employees 1/ assigned increased from 596 as of June 30, 1954, to a peak of 6,425 as of June 30, 1966. The number of U.S. employees decreased to 5,291 as of June 30, 1968, and 4,639 as of June 30, 1969.

Using 1969 as the starting point for determining plan assets based on contributions would not recognize any termination gains relating to the employees who terminated prior to January 1, 1969. Also, because the terminations have resulted in reduced liability for Government contract employees, the Government would receive a reduced share of assets distributed on the basis of actuarial liability. Further, an employee who terminated before that date is likely to generate greater termination gains because the employee is less likely to be vested. Data provided by Pan Am showed that the percentage of employees who terminated from the ASD projects with a vested right to pension benefits was 6 percent, 18 percent, and 38 percent for 1975, 1976, and 1977, respectively.

1/Pan Am also employs indigenous personnel at foreign down-range tracking stations.

CONCLUSIONS AND RECOMMENDATIONS

Although nearly 2 years had passed since we briefed Air Force and Pan Am officials in August 1979, actions that would result in proper recognition of termination gains for 1975 to 1977 had not been completed as of July 1981. Also, the method to be used by Pan Am to allocate pension fund assets among segments would not recognize each segment's experience prior to 1969 and, thus, may result in an inequitable distribution of assets.

We recommend that you ensure that the distribution of assets among CRIP and the various CRIP/ASD projects is equitable and timely. The net contribution method should be used for determining what the ASD/CRIP projects' assets should be for years before 1969, as well as for 1969 and later years.

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As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We would appreciate your comments on the findings and recommendations in this report, including any actions you take or plan to take.

Copies of this report are being sent to the Chairmen of the four above-mentioned Committees and to other interested congressional committees and subcommittees and to the Director, Office of Management and Budget.

We appreciate the courtesy and cooperation extended to our representatives during this review.

Sincerely yours,

Gregory J. Ahart
Director

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